



# LumberMEMO

Pennsylvania Lumbermens Mutual Insurance Company

Special Edition

## Financial Strength and the Promise to Pay

Jerry Healy, Vice President of Marketing

PLM regularly produces four editions of the LumberMemo every year. Each of these newsletters generally contains articles or information on four or five topics that we hope will provide you with some useful information in running your business. We also use the LumberMemo to keep you updated on happenings at PLM, a company where you maintain membership if you are a policyholder. For those non-members, we hope the newsletter will provide information that might cause you to consider PLM when you make the decision concerning the placement of your commercial insurance.

We feel the topic of this Special Edition LumberMemo is important enough to dedicate the entire issue to it. That topic is the financial “strength” of your insurance company and what that means about its “promise to pay”. Insurance companies provide helpful services in addition to paying claims. The two most obvious are risk management consultation and loss control/mitigation services. At the end of the day, however, they provide for the transference of financial risk that you cannot or do not want to assume. That risk involves more immediate types of events such as a fire destroying your place of business. It also involves long-term events that most of us would never have considered as potential financial risk issues

**A more important question might be: are they [insurance companies] financially strong enough today and managed in such a fashion as to be around when that long-term event surfaces ten, twenty or thirty years from now?**

(i.e. the manufacture and sale of asbestos containing products).

When considering which insurance company or companies to trust with this transfer of financial risk, you have to ask yourself if they will be financially strong enough to



handle an event during your policy term. A more important question might be: are they financially strong enough today and managed in such a fashion as to be around when that long-term event surfaces ten, twenty or thirty years from now? Almost all commercial insurance policies are written on an “occurrence” basis, meaning the company that was providing coverage at the time the event or “occurrence” took place, is the company responsible for the handling of any potential claims resulting from that event or “occurrence”.

With this background, I ask that you please take a look at the article below concerning PLM’s A.M. Best rating. Then, carefully consider the ideas discussed in the article on the reverse side of this edition of the LumberMemo written by our Senior Vice President of Finance, Mr. Michael O’Malley.

If you have any questions please give us a call. Thank you for considering PLM and trusting us with your business.

### A.M. Best Reaffirms PLM’s A “Excellent” Rating

A.M. Best, one of the most recognized and respected insurance industry rating organizations, has reaffirmed PLM’s “A Excellent” rating with a “stable” outlook. The report was released on March 21st, 2006.

The rating rationale reflects PLM’s “very strong capitalization, strong operating results and the company’s established market presence”. The write-up goes on to state that “Driven by management’s corrective actions that were implemented several years ago... the company has reported very strong operating results over the most recent five-year period. Underwriting results have been stellar as PLM’s five-year average combined ratio approximates 95%.”

PLM has maintained a rating in the “A” category since its inception in 1895. In our view, maintaining our financial strength, stability and strong underwriting results is crucial for our policyholders and the company’s continued success going forward.

#### LumberMEMO

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# Why You Should Make the Critical Insurance Carrier Selection Decision for Your Company

Michael O'Malley, Senior Vice President of Finance



In the last few years, the Property/Casualty insurance industry has experienced unprecedented volatility due to a variety of severe storm losses, in particular, hurricanes. Many primary insurance carriers and reinsurers both large and small have been affected by losses resulting from large Florida and Gulf Coast hurricanes in the last few years. The result has been volatility in the “financial strength” ratings of many insurance carriers.

While most carriers were able to meet their claim obligations, many carriers have been weakened by the magnitude of these storm-related disasters. As a result, it's more important than ever to confirm the “financial strength” rating of your insurer before finalizing your insurance purchase decision to make sure that your carrier's “financial strength” has not been impaired.

## Keeping up with Current Ratings

Meteorologists are predicting continued threats of high intensity storms for the foreseeable future. Buyers shouldn't assume that the past severe storm events can't occur again in the near future.

In order to obtain the most up-to-date information on the carriers you're considering, you should ensure that you're obtaining rating information from insurance rating organizations that issue interim rating updates. A.M. Best and S&P provide rating updates, but S&P's ratings are largely provisional in nature for the bulk of Property/Casualty insurers, unless a carrier pays for the more in depth rating service that they offer. A.M. Best provides more comprehensive industry-wide rating coverage and utilizes a proprietary risk-based capital model (BCAR) to assist in their rating evaluation process.

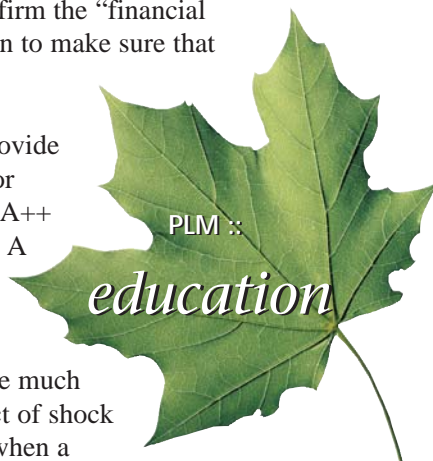
It is important for insurance purchasers to be aware that some carriers decline or refuse to be rated if their financial strength has been impaired. So be sure you only consider companies that have a current rating.

Also be sure that you focus your insurance carrier search on companies that are highly rated (A- or better) and have been highly rated for at least the last three to five years. Most rating agencies require carriers to maintain a consistent level of profitability over a three to five year period in order to maintain their rating at a given level. If ratings are declining, then consistency of operating results and surplus growth may not have been maintained.

Another important evaluation consideration is whether the carriers you are exploring have been successful in building their surplus position over a period of years. A stronger surplus position equates to a better quality financial guarantee that backs up your carrier's promise of prompt claim settlement.

A.M. Best maintains a website ([www.ambest.com](http://www.ambest.com)) that offers updated and specific insurance carrier rating information. You'll need to enter the Company's name unless you know their NAIC or A.M. Best Company number. The NAIC number may appear on your auto insurance identification card if you buy all your insurance coverages from the same carrier. You will only receive the rating itself and the rating modifier, e.g. “A” “Excellent”.

There are four ratings that provide excellent financial security for insurance purchases, namely A++ and A+ “Superior” as well as A and A- “Excellent”. Ratings below “A” in the “B” range (B++, B+ and B) may be described as “Secure”, but are much more vulnerable to the impact of shock losses, like those that occur when a company is impacted by a series of large catastrophe losses.



## Get the Complete Picture

To be sure you have a complete picture about the financial strength of your current or intended insurance carrier it is well worth the cost of purchasing a complete Best's Company (rating) Report for a particular company (which runs about \$75). This report will give you insights into your carrier's operations, including the financial results, balance sheet, and A.M. Best rating history for the last five years. This information will enable you to make a more informed decision about your insurance purchase.

Insurance premium pricing is influenced somewhat by the financial strength of an insurance carrier. Consequently, premium quotations from different carriers may vary in price and the highest rated carriers may charge a slightly higher premium than the average carrier. Many people are motivated to choose the company with the lowest premium quote, but this can be a serious mistake motivated by false economy.

Unless you know the quality of the carriers you're considering, you can't evaluate the reasonableness of the various price quotations you receive. In the final analysis, insurance is about ensuring your business's future financial security. This decision warrants the purchase of a quality insurance product that can only be offered by a highly rated and financially strong insurance carrier.

This purchase decision is, therefore, an important decision for your company that requires your personal involvement. The importance of this decision is well worth the extra research required. You'll be making an informed decision about your insurance purchase that more than justifies your time and effort.